



Executive Summary November 2010

Quebec's Fiscal Situation The Alarm Bells Have Sounded

At a Glance

- ◆ This report focuses on the overall fiscal health of the Government of Quebec.
- ◆ An aging population will have a dual effect on Quebec's fiscal health: it will drive up health-care spending, and it will put a damper on the province's potential economic growth.
- ◆ If the government wishes to maintain its fiscal balance while sustaining its current spending programs, it will need to continue increasing the QST in subsequent years until the sales tax reaches 19.5 per cent in 2030.
- ◆ The alarm bells have sounded!

Over the last 10 years, The Conference Board of Canada has published numerous reports on the financial situation of governments at all levels—federal, provincial, and municipal. Our new report highlights the overall fiscal health of Quebec and its provincial government. The report is especially timely given the current debate over spending and universal health care. The report presents our forecasts for the Quebec government's fiscal balance for the 2010–31 period, taking into consideration the province's aging population and its impact on Quebec's public spending and revenues. This major demographic change will clearly have considerable repercussions, particularly on public health-care spending. The 65-and-older age group will represent a steadily expanding proportion of the Quebec population over the next 20 years. Given that this age group

2 | Quebec's Fiscal Situation—November 2010

requires the greatest level of health care, one may well ask: How can the Quebec government—which did show courage in its 2010 budget—manage its budget in such a situation? This report attempts to answer this and several other questions.

To complete our forecast of the Quebec government's fiscal situation, we used the Conference Board's long-term economic projections. Prepared by the Conference Board for the past 20 years, these projections provide us with the basic information needed to forecast the Quebec government's revenues and expenditures. In the case of revenues, for instance, we have applied implicit tax rates to economic variables such as personal income, corporate profits, and consumer spending. For this exercise, we adopted the underlying hypothesis that current taxation rates will remain unchanged—except for the sales tax rate, which will be increased (as the Quebec government has already announced) by one percentage point in January 2011 and by another percentage point in January 2012. It is important to stress that all tax changes already announced and passed by the legislature are included in our projections.

We have based Quebec's public health-care and education spending on models that start with the trend of actual per capita costs in real terms. The forecast then adds other key factors—inflation, demographic growth, and the change in the population's age structure over the forecast period. The effect of the aging population is thus included in the fiscal forecast, but does not impact the actual amount of money being spent on an individual of a given age. (Note: The demographic projections used for the economic and financial forecasts come from work produced jointly by the Conference Board and Statistics Canada).

The results of our research are strikingly clear. If Quebec's taxation rates remain unchanged and the historical trends of actual per capita program spending are maintained, the Quebec government is headed for deep fiscal trouble. The Conference Board estimates that by the end of fiscal 2030–31, the Quebec government would post an annual deficit of \$45 billion—this, despite an assumed continued increase in federal transfer payments.

It must be emphasized that our base case forecast remains hypothetical and that the reality will no doubt be different. This forecast assumes no further changes in fiscal policy other than the changes already announced in recent budgets, including the 2010 budget. Clearly, the Quebec government will respond to the fiscal threats suggested by our base case scenario with new initiatives aimed at preventing the province's fiscal situation from going off the rails. However, this base case scenario is useful in that it provides a measure of the magnitude of the problem.

This disturbing trend toward a deepening deficit—as outlined in our base case scenario—is due to modest economic growth and the related effect on revenue growth, which will lag far behind growth in overall expenditures. Specifically, the Conference Board forecasts that Quebec's real economic growth will average 1.6 per cent per year for the 2009–10 to 2030–31 period as a whole, but will actually fall below 1.5 per cent per year in the final 10 years. This tepid performance will be due to weak population growth, which will average only 0.7 per cent per year over the next 20 years, and will in fact drop to just 0.5 per cent per year over the final four years of the forecast.

Quebec's deepening deficit in our base case scenario is due to modest economic growth and related revenue growth, which will lag far behind overall expenditure growth.

In this demographic and economic context, the Quebec government's revenue growth will be limited to 3.5 per cent per year over the final five fiscal years of the forecast period, and to an average of 4 per cent per year over the entire forecast period. At the same time, expenditures will increase at an average annual rate of 5.1 per cent. The main reason for this substantial rise in expenditures will be the rapid increase in health care expenditures. The Conference Board forecasts that the Quebec government's spending on health-care will grow at an average annual rate of 5.9 per cent over the entire forecast period. Of this increase, 2.5 percentage points will be attributable to inflation, 1.7 percentage points to real per capita increases in health-care spending (for

technological upgrades, improved accessibility, etc.) and 1.8 percentage points to demographic factors (1.1 percentage points due to the aging population and 0.7 percentage points because of population growth).

The other spending category that will pose a problem for the Quebec government in this scenario will be debt servicing, which will post average annual growth of 8.2 per cent between 2009–10 and 2030–31. This will be caused by an increase in the Quebec government's indebtedness during the forecast period, in tandem with the rapidly rising deficit. Nonetheless, in absolute terms, health-care spending will rise the most—and thus contribute the most to the government's deficit during the forecast period. Specifically, health-care spending will rise from \$27 billion in 2009–10 to \$90.2 billion in 2030–31, for a net increase of approximately \$63 billion. In fact, health-care spending as a percentage of total revenues will rise from 43.1 per cent in 2009–10 to 63.4 per cent in 2030–31. In comparison, debt-service expenditures will rise from \$6.2 billion in 2009–10 to \$32.1 billion in 2030–31, to constitute 22.5 per cent of total revenues at the end of the forecast horizon.

In our analysis, other spending categories will post growth virtually identical to that of revenues, averaging 3.3 per cent growth per year between 2009–10 and 2030–31. Noteworthy among the other expenditures is education. Our simulation shows that the Quebec government's education spending is likely to increase at an average annual rate of 3.7 per cent between fiscal 2009–10 and fiscal 2030–31. The main difference between education and health-care spending is the projected evolution in the beneficiaries of each of these expenditures. In the case of health care, the aging of the population—led by the baby boomers—will increase the number of people in the age

brackets where costs are highest. In fact, the 65-and-older population is expected to expand by an average of 3 per cent per year over the next 20 years, whereas the 5–24 age group will expand by an average of only 0.4 per cent per year during that period. This radically different demographic pattern for these two age brackets is largely responsible for the growing gap between trends in health-care spending and those in education spending.

Our research pursued the analysis one step further by asking the following question: What—based on such an expenditure scenario—would be the rate of the Quebec provincial sales tax at the end of the forecast period if the Quebec government tried to maintain a balanced budget until 2030–31? The answer is a provincial sales tax rate of 19.5 per cent. In other words, the QST would need to rise by another 10 percentage points from January 1, 2012 (when it will be at 9.5 per cent) to the end of the forecast period. Is such a tax rate possible? In France, the value-added tax (VAT) currently stands at 19.6 per cent. But is it politically “doable” in Quebec? It is not for the Conference Board to answer this question—it is up to the people of Quebec.

But the alarm bells have sounded! If Quebecers want to maintain universal health care, they have the ability to do so—but they must realize that such a choice has a price. And if they want their university students to continue paying some of the lowest tuition fees in North America, there again, it is for them to decide and accept the consequences. While The Conference Board of Canada has no interest in telling the Quebec government what to do, it does feel duty-bound to warn Quebecers that their government's financial situation is shaky—and that maintaining the status quo is not an option.

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